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QUESTION PRESENTED

Whether the federalism principles that undergird the state action doctrine, coupled with principles of fundamental fairness, permit the imposition of federal antitrust liability upon persons acting pursuant to a lawful state regulatory regime, on the basis of a subsequent determination by a federal antitrust tribunal that the state's implementation of its regulatory regime was not effective.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-72

FEDERAL TRADE COMMISSION,

Petitioner,

v.

TICOR TITLE INSURANCE CO., *et al.*,

Respondents.

BRIEF OF THE AMERICAN LAND TITLE ASSOCIATION
AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

INTEREST OF AMICUS CURIAE

The American Land Title Association ("ALTA") is a voluntary trade association comprised of title insurance underwriters, agents, attorneys and others involved in the conveyance of real property throughout forty-nine states, the District of Columbia, and the territories. The business of ALTA's members is uniquely local in nature, and is the subject of state regulatory scrutiny in each of the states in which its members conduct business. The insurance functions of ALTA's members are, and have always been, conducted pursuant to pervasive state regulation and extensive oversight by state insurance departments.

ALTA and its constituency view the issues raised in this case to be of critical importance. The test of active supervision advanced by the petitioner will, if adopted, undermine the confidence of regulated entities in the integrity of state regulatory processes, and will thereby undermine state regulation itself. The very facts of this case under-

score the need for this Court to adopt a test of active supervision that will lend credibility to state regulation, and thereby provide certainty to regulated entities that they will not become the unwitting subjects of federal antitrust attack for the mere act of conducting themselves in accordance with state law.¹

STATEMENT OF THE CASE

On January 7, 1985, petitioner Federal Trade Commission ("FTC" or the "Commission") initiated an enforcement action alleging that six title insurance companies had violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45(a)(1) (the "FTC Act"), by filing title insurance rates with state insurance regulators through state authorized rating bureaus in thirteen states. Pet. App. at 44a. Prior to the administrative hearing, and following this Court's decision in *Southern Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48 (1985), the FTC staff announced its decision not to pursue its claims against the insurers in five states. The case then proceeded to hearing with respect to the rating bureau activities of the title insurers in eight states.

On December 22, 1986, the Administrative Law Judge ("ALJ") found, *inter alia*, that the five title insurance companies² had violated the FTC Act in two states, but that the state action doctrine protected the challenged conduct in the remaining six states. Pet. App. at 248a. The insurance companies and the FTC complaint counsel cross-appealed the ALJ decision to the full Commission. Pet. App. at 45a.

On September 19, 1989, the Commission issued its Opinion and Final Order. Pet. App. at 44a. The FTC, which concluded, *inter alia*, that the state action doctrine did

¹ Pursuant to Rule 37.3 of the Rules of this Court, this brief is filed with the consent of the Petitioners and Respondents. Letters of consent from all parties are being filed concurrently herewith.

² The sixth title insurance company originally charged entered into a consent agreement with the FTC. Pet. App. at 137a n.1.

not shield the rate filing activities of the title insurers, found a violation of the FTC Act in Arizona, Connecticut, Montana, New Jersey, Pennsylvania, and Wisconsin. Pet. App. at 46a.³ The Commission's decision on the state action issue generated three separate opinions (plus one additional statement) from the three participating Commissioners. Pet. App. at 44a.⁴

The title insurance companies appealed the decision of the Federal Trade Commission to the United States Court of Appeals for the Third Circuit, which, on January 9, 1991, reversed the FTC's Opinion and Final Order in its entirety. *Ticor Title Ins. Co. v. FTC*, 922 F.2d 1122 (3d Cir. 1991), Pet. App. at 1a. The Third Circuit held that the filing by the title insurance companies of rates through state licensed rating bureaus in the states at issue was authorized and was actively supervised by those states. Pet. App. at 38a. It rejected the FTC's approach to active supervision as overly intrusive, and adopted a test that it described as more in keeping with the federalism underpinnings of the state action doctrine as enunciated by this Court. Pet. App. at 57a.

In July of 1991, the FTC petitioned this Court for a writ of certiorari. That petition was granted on October 7, 1991.

SUMMARY OF ARGUMENT

In *Parker v. Brown*, 317 U.S. 341 (1943), this Court held that the federal antitrust laws could not be employed to invalidate a state regulatory program. The state action doctrine that emerged from this holding provides that con-

³ Although the Third Circuit below reversed the FTC's decision with respect to state action in Pennsylvania and New Jersey, that aspect of the Third Circuit's decision is not a subject of review before this Court.

⁴ The two other active Commissioners did not register votes in this case. The fourth vote of the FTC came from former Chairman Oliver, who registered his vote prior to leaving the Commission. Pet. App. at 41a, 43a.

duct undertaken pursuant to a state regulatory program is exempt from federal antitrust attack.⁵ Grounded in principles of federalism, it is a doctrine that commands that the states must be free to engage in legitimate regulation of economic activities within their borders without undue interference by the federal government. It is also a doctrine that recognizes that, in order for states to regulate effectively, regulated entities must be able to rely upon the integrity of the state regulatory process.

The FTC's approach to active supervision in this case undermines the very goals that the doctrine was established to promote. The Commission's test invites rigorous substantive scrutiny of state regulatory determinations by federal antitrust tribunals. This approach to the *Parker* doctrine, and indeed any test that invites the federal antitrust camel to stick its nose into the state regulatory tent, cannot be reconciled with this Court's own admonition that states must be free to experiment with economic regulation without intrusion by federal antitrust tribunals.

The Court of Appeals below, while properly rejecting the Commission's interpretation of the state action doctrine, nevertheless adopted a test that invites federal scrutiny of the substance of state regulatory conduct. And though the Third Circuit's application of that test to the facts of this case avoided such scrutiny, the test itself offers no certainty that future federal tribunals will exercise such restraint.

The only test of active supervision that is fully consistent with this Court's teachings is one that focuses exclusively on the structure of a state's regulatory program, without in any way looking behind that structure to the actual conduct of the state regulator. This objective test of active supervision is the proper test for several reasons. First, by focusing exclusively upon the regulatory regime

⁵ The instant case involves the application of the state action doctrine to the conduct of private parties who are subject to state regulation. The issue of municipal state action, to which a different test is applied, is not raised by this case.

itself and not upon the effectiveness, wisdom or correctness of its implementation, a structural, or objective test is the only approach that is fully responsive to the federalism principles that lie at the core of the state action doctrine. Second, it is the only approach that prevents parties from utilizing federal antitrust processes to remedy perceived imperfections in the performance of state regulatory functions. Third, the objective test protects against the use of liberal federal discovery rules to invade the deliberative processes of state actors. Finally, it is the only approach to active supervision that avoids resting the liability of private actors on the subsequent conduct of state regulators—a blend of *ex post facto* and vicarious liability that strains and could easily exceed the boundaries of due process. The objective test also possesses the virtue of simplicity; it is easy to apply and administer, and it properly steers the federal courts away from complex intrusions into state regulatory activity.

ARGUMENT

In the decision below, the Court of Appeals held that the record of state supervision over title insurance rating bureaus in Arizona, Connecticut, Montana, and Wisconsin satisfied the requirements of the state action doctrine.⁶ Accordingly, the Court of Appeals reversed the Opinion and Final Order of the FTC, which held that the title insurance companies had violated the federal antitrust laws by participating in state authorized rating bureaus. 922 F.2d 1122, Pet. App. at 1a-40a.

The Court of Appeals refused to accept the FTC's notion that state action protection is only available to private parties after a federal antitrust tribunal has conducted a *de novo* review of state agency action and has determined that the state regulators properly balanced the interests

⁶ The question of whether these states had clearly articulated and affirmatively expressed policies removing title insurance ratemaking from the competitive sphere and placing it within a sphere of state regulation was not contested in this case.

of state policy against the federal goals of unfettered competition. Relying on the underlying purposes of the state action doctrine, the Third Circuit concisely laid waste to the FTC's approach to active supervision:

The FTC held that Arizona, Connecticut, Montana and Wisconsin failed *Midcal's* adequate supervision prong because the regulators in those states were unqualified, they approved rates that the FTC's commissioners would not have approved and they generally did not regulate to the degree that the FTC found desirable. Even if the FTC is correct, its conclusions miss the point. Availability of the state action doctrine does not depend upon the quality of state supervision. The principles of federalism and state sovereignty that undergird the doctrine prohibit its selective application only where states act in a manner that a federal agency or federal court finds to be preferable.

922 F.2d at 1140, Pet. App. at 37a.

The test adopted by the Third Circuit attempts to embrace the federalism concerns that lie at the core of the state action doctrine, but falls short. Its test properly inquires whether a state regulatory program (1) is in place, (2) is staffed and funded, (3) grants regulators the power and duty to regulate pursuant to declared standards of state policy, and (4) is enforceable in the state's courts. Pet. App. at 28a (citing *New England Motor Rate Bureau v. FTC*, 908 F.2d 1064, 1071 (1st Cir. 1990)). However, it also requires a showing of some "basic level of activity" by state regulators. *Id.* By inviting federal inquiry into the "basic level" of state regulatory activity, the Third Circuit's test opens the door to the same wholesale intrusion into state regulatory processes by federal-antitrust tribunals that served as the basis for its rejection of the FTC's test. The only difference between the two approaches is that the Third Circuit *applied* its test in a manner that was properly deferential to state regulatory

autonomy, while the FTC applied its test with no semblance of such deference. There is no guarantee, however, that future tribunals applying the Third Circuit's test will be so restrained.

A purely objective test of active supervision inquires into the existence of a comprehensive regulatory regime designed to promote state rather than private ends, without looking to the effectiveness of the state's implementation of its regime. This is the only approach to active supervision that advances the federalism goals of the state action doctrine and avoids the myriad problems that the tests proposed by the FTC and the Third Circuit would produce.

I. The State Action Doctrine Does Not Permit Federal Tribunals To Look Behind The Structure Of State Regulatory Programs To The Actual Substance And Effectiveness Of Regulatory Conduct.

A. The Principal Focus Of The State Action Doctrine Is The Preservation Of State Regulatory Autonomy Free From Federal Interference.

As this Court made clear in *Parker*, principles of federalism lie at the very heart of the state action doctrine. *Parker* involved a federal antitrust challenge to a state run program governing the marketing of California's raisin crop. This Court evaluated the challenged state program and concluded that it was not the product of private agreement; rather, it "derived its authority and its efficacy from the legislative command of the state and was not intended to operate or become effective without that command." 317 U.S. at 350. Furthermore, this Court found that it was neither in the language nor in the purposes of the Sherman Act to restrain a state or its agents from activities directed by its legislature. "In a dual system of government, in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress." *Id.* at 351. Accordingly, in deference to the primacy of state economic reg-

ulation, this Court rejected the plaintiff's Sherman Act challenge.

This Court revisited the *Parker* doctrine in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), where a Sherman Act attack was directed against a state liquor pricing program under which wine producers, wholesalers, and rectifiers were required to file price schedules with the state. The governing statute, however, did not give the state direct control over the prices, nor did it enable the state to review the reasonableness of the posted prices. *Id.* at 99-100. For this reason, this Court found that the regulatory program at issue violated the Sherman Act.

In reaching its conclusion, this Court briefly surveyed its own previous applications of the *Parker* doctrine, and defined a two-pronged test for state action immunity. "First, the challenged restraint must be 'one clearly articulated and affirmatively expressed as state policy'; second, the policy must be 'actively supervised' by the State itself." 445 U.S. at 105 (citation omitted). The Court then applied this test to the liquor pricing mechanisms under attack. It found prong one to be easily satisfied, because "[t]he legislative policy [was] forthrightly stated and clear in its purpose to permit resale price maintenance." 445 U.S. at 105.

The Court was not persuaded, however, that the second prong of the *Midcal* test—active supervision—had been satisfied, because:

The State simply authorizes price setting and enforces the prices established by private parties. The State neither establishes prices nor reviews the reasonableness of the price schedules; nor does it regulate the terms of fair trade contracts. The State does not monitor market conditions or engage in any 'pointed reexamination' of the program. The national policy in favor of competition cannot be thwarted by casting such a gauzy cloak

of state involvement over what is essentially a private price-fixing arrangement.

445 U.S. at 105-106 (footnote omitted). This Court nevertheless emphasized that the state action doctrine, and the two-pronged test formulated thereunder, "is grounded in our federal structure" pursuant to which, "under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority." *Id.* at 103.

In 1985, this Court strongly reaffirmed the federalism underpinnings of the state action doctrine. In *Southern Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48 (1985), motor common carrier rate bureaus in five states were sued for violating the Sherman Act by filing joint rate proposals with state regulators pursuant to permissive, rather than compulsory, regulatory programs. The rate bureaus' state action immunity arguments were rejected by the United States Court of Appeals for the Fifth Circuit, which held that compulsion was a threshold requirement for satisfying the first prong of the *Midcal* test. *United States v. Southern Motor Carriers Rate Conference, Inc.*, 702 F.2d 532 (5th Cir. 1983)(*en banc*).

This Court reversed the Fifth Circuit's state action holding, concluding that actions undertaken by private parties may be attributed to a "clearly articulated state policy" within the meaning of *Midcal*'s first prong, even in the absence of compulsion. 471 U.S. at 59-60. In reaching its conclusion, this Court bridged the 45-year history of the state action doctrine and reasserted the principles that lay at the core of the Court's decision in *Parker*. Addressing the dichotomy between competition and state regulation, *Southern Motor Carriers* made clear which factor predominates, stating that "[t]he *Parker* decision was premised on the assumption that Congress, in enacting the Sherman Act, did not intend to compromise the States' ability to regulate their domestic commerce." *Id.* at 56 (footnote omitted). *Southern Motor Carriers* thus concluded that a compulsion requirement was inconsistent with the feder-

alism underpinnings of the state action doctrine because "[i]t reduces the range of regulatory alternatives available to the State." *Id.* at 61.

The unmistakable focus of these decisions is a recognition that the state action doctrine was intended to preserve state "regulatory alternatives" by giving states broad flexibility to control economic activities within their borders. In *Parker*, the Court strongly endorsed the primacy of state economic regulation, absent express federal preemption. The *Southern Motor Carriers* decision flatly rejected any test of state action that "would prompt the 'kind of interference with state sovereignty . . . that . . . *Parker* was intended to prevent.'" *Id.* at 57-8 n.20 (quoting 1 P. Areeda & D. Turner, *Antitrust Law* ¶ 214, p. 88 (1978)). And in *Midcal*, this Court relied upon the deferential basis of the state action doctrine to fashion a two-pronged test that focused upon the structure rather than the execution of state regulatory programs.

These decisions demonstrate that the primary goal of the state action doctrine is to preserve state regulatory autonomy. Although the Third Circuit's application of its active supervision test was fully responsive to these federalism concerns, neither its test nor that of the FTC will protect states or regulated entities from substantive federal review. Only a test of active supervision that looks solely at the existence of a comprehensive regulatory structure, without allowing the federal government to look behind that structure, can serve the true purposes of the state action doctrine.

B. An Objective Test Of Active Supervision Is Fully Consistent With *Patrick v. Burget* And With The Holdings Of The Appellate Courts That Have Addressed This Issue.

This Court's most recent effort to define the parameters of the active supervision prong of the *Midcal* test can be found in *Patrick v. Burget*, 486 U.S. 94 (1988). Patrick was an Oregon surgeon who brought an antitrust challenge against a hospital peer review committee that terminated

his staff privileges at the only hospital in the community. The defendants contended that the peer review process was protected from antitrust challenge under the state action doctrine because hospitals were required by state law to establish peer review procedures and review those procedures on a regular basis.

The Court concluded that "active supervision" had not been demonstrated, and rejected the state action defense. *Id.* at 100. It explained that the active supervision requirement "is designed to ensure that the state-action doctrine will shelter only the particular anticompetitive acts of private parties that, in the judgment of the State, actually further state regulatory policies." *Id.* at 100-01 (citing *Town of Hallie v. City of Eau Claire*, 471 U.S. 34, 46-47 (1985)). It then fashioned an approach to active supervision that applied to the specific facts of the case before it, concluding that:

[t]he active supervision prong of the *Midcal* test requires that state officials have and exercise power to review particular anticompetitive acts of private parties and disapprove those that fail to accord with state policy. Absent such a program of supervision, there is no realistic assurance that a private party's anticompetitive conduct promotes state policy, rather than merely the party's individual interests.

486 U.S. at 101.

With this legal framework in place, the *Patrick* Court reviewed the statutory mechanisms governing peer review practices in Oregon. It concluded on the basis of this statutory evaluation that the state regulators *could not* review hospital peer review decisions to determine whether such decisions comported with state regulatory policies, and that they could not correct any abuses. *Id.* at 102-03. Moreover, the statutory provisions governing state judicial review of peer review determinations limited such review to the procedural, rather than the substantive infirmities of peer review decisions. *Id.* at 104. This Court thus held, on the

basis of this survey of the Oregon statute that the active supervision requirement had not been met. *Id.* at 105.

Ignoring *Patrick's* narrow focus upon the absence of *statutory* mechanisms for state supervision of the private peer review process, the FTC in this case has relied on the "have and exercise" language of *Patrick* to justify a veritable ransacking of state regulatory records to determine whether the states "exercised" their regulatory authority or control in accordance with state policy. *See e.g.* Brief for Petitioner at 21. A closer look at the origins of this "have and exercise" language, however, cannot support such a reading.

There is no mystery surrounding the source of *Patrick's* "have and exercise" language; *Patrick* itself credits *Southern Motor Carriers* for the phrase. But *Southern Motors Carriers* plainly did not contemplate the intrusive construction of "have and exercise" that the FTC has advanced. In fact, this Court in *Southern Motor Carriers* concluded—*solely* by reference to the *statutory* provisions in place in those states—that the State Public Service Commissions under scrutiny "have and exercise ultimate authority and control over all intrastate [trucking] rates."⁷ The very decision in which the phrase was first announced demonstrates, through its own usage, that it contemplates

⁷ 471 U.S. at 50-51. This Court stated:

In North Carolina, Georgia, Mississippi, and Tennessee, Public Service Commissions set motor common carriers' rates for the intrastate transportation of general commodities. Common carriers are required to submit proposed rates to the relevant Commission for approval. A proposed rate becomes effective if the state agency takes no action within a specified period of time. If a hearing is scheduled, however, a rate will become effective only after affirmative agency approval. *The State Public Service Commissions thus have and exercise ultimate authority and control over all intrastate rates.*

Id. (emphasis added)(footnotes omitted). All supporting citations to the above-quoted language were to state statutory provisions. *Id.*

nothing more intrusive than a review of the governing statutory provisions.

Nor does a fair reading of *Patrick* suggest any intention on the part of this Court to require more than a system of regulatory oversight to satisfy the active supervision test; the holding was based upon the Oregon legislature's failure to provide its regulators with "*statutory authority*" to review the substance of the challenged peer review activities:

This *statutory scheme* does not establish a state program of active supervision over peer-review decisions. The Health Division's *statutory authority* over peer review relates only to a hospital's procedures; that authority does not encompass the actual decisions made by hospital peer-review committees. . . . The state does not actively supervise [the termination of staff hospital privileges] unless a state official has and exercises ultimate authority over private privilege determinations. *Oregon law does not give the Health Division this authority: under the statutory scheme the Health Division has no power to review private peer-review decisions and overturn a decision that fails to accord with state policy.*

486 U.S. at 102-03 (emphasis added)(footnote omitted).⁸ This Court therefore concluded, on the basis of the Oregon statutes alone, that "the activities of the Health Division under Oregon law cannot satisfy the active supervision requirement of the state-action doctrine." *Id.*

⁸ Throughout its decision, this Court in *Patrick* emphasized that its active supervision holding flowed from its review of the state's *statutory* mechanisms for supervision. *See, e.g., id.* at 102 n.6 (statutory scheme provides for only limited review of even the peer review procedures); *id.* at 103 and n.7 (statutory provisions governing state Board of Medical Examiners provides no mechanism for supervising peer review decisions); *id.* at 104 (state statutes do not provide for judicial review of privilege terminations).

This approach to active supervision, and the factual context in which it arose, was indistinct from the holding in *Midcal*, where the Court found supervision lacking because the statute at issue did not enable state regulators to "monitor market conditions or engage in any 'pointed reexamination' of the program." 445 U.S. at 106. Similarly, in *324 Liquor Corp. v. Duffy*, 479 U.S. 335 (1987), this Court concluded that, where the state statute did not give the regulators authority to approve or disapprove of privately set price schemes, there was no active supervision because "[t]he state has displaced competition among liquor retailers without substituting an adequate system of regulation." *Id.* at 345 (emphasis added).

Each of these decisions rejected the state action defense because the governing statutes and regulations did not empower state regulators to supervise the conduct under attack. Significantly, both *Midcal* and *Duffy* discussed hypothetical state statutory programs that this Court felt would satisfy the active supervision requirement.⁹ And in *New Motor Vehicle Board v. Orrin W. Fox Co.*, 439 U.S. 96 (1979), decided prior to *Midcal*'s formal enunciation of the active supervision requirement, this Court upheld the assertion of the state action defense based *solely* upon a review of the governing statutory regime. *Id.* at 109.

Indeed, although prior to this case this Court has never expressly addressed the active supervision issue in a context in which state laws actually provide for regulatory

⁹ *Midcal*, 445 U.S. at 106 n.9 ("[t]he California program contrasts with the approach of those States that completely control the distribution of liquor within their boundaries. *E.g.*, Va. Code §§ 4-15, 4-28 (1979). Such comprehensive regulation would be immune from the Sherman Act under *Parker v. Brown*, since the State would 'displace unfettered business freedom' with its own power") (citations omitted); *Duffy*, 479 U.S. at 344-45 n.6 ("[a] simple 'minimum markup' statute requiring retailers to charge 112 percent of their actual wholesale cost may satisfy the 'active supervision' requirement, and so be exempt from the antitrust laws under *Parker v. Brown*, 317 U.S. 341 (1943). See *Morgan v. Division of Liquor Control*, 664 F.2d 353 (2d Cir. 1981) (upholding a simple markup statute)").

oversight of private anticompetitive activity, the Courts of Appeals have done so on numerous occasions and have consistently refused to look behind the statutory scheme to the actual conduct of the state regulators. See, e.g., *Llewellyn v. Crothers*, 765 F.2d 769, 773-74 (9th Cir. 1985) (availability of state action immunity depends not upon a subjective review of the conduct of the regulators but upon the "satisfaction of the objective standards set forth in *Parker* and authorities which interpret it"); *Capital Telephone Co. v. New York Telephone Co.*, 750 F.2d 1154, 1163-64 (2d Cir. 1984), *cert. denied*, 471 U.S. 1101 (1985) (finding active supervision on the basis of the existence of a comprehensive regulatory structure); *Marrese v. Interqual, Inc.*, 748 F.2d 373 (7th Cir. 1984), *cert. denied*, 472 U.S. 1027 (1985) (statutory authority of regulators to supervise physician peer review held to satisfy active supervision requirement); *Euster v. Eagle Downs Racing Ass'n*, 677 F.2d 992, 997 (3d Cir.), *cert. denied*, 459 U.S. 1022 (1982) (active supervision is a "question of law, generally an issue of statutory construction" which does not permit "inquiry into state legislative wisdom").

The undisputed statutory record in this case amply demonstrates the existence of comprehensive regulatory programs for the supervision of the rating bureaus and their members in Arizona, Connecticut, Montana, and Wisconsin. Joint App. at 166-211. In fact, the statutes governing the insurance rating bureaus in this case were at least as extensive as those that governed the motor carrier rate bureaus in *Southern Motor Carriers*—statutes that this Court found to have demonstrated that the state regulators "have and exercise ultimate authority and control over all intrastate rates." 471 U.S. at 50-51. Thus, this Court's state action holdings, as well as an unbroken line of appellate court precedents, demonstrates that the extensive, expansive, intrusive, and disruptively microscopic nitpicking of the state regulatory records that has occurred throughout the tortured history of this case is entirely inappropriate and unnecessary to the legal resolution of the active supervision question.

II. An Objective Test of Active Supervision Precludes Federal Second Guessing Of State Regulatory Determinations.

The FTC's approach to the record in this case—drawn from the multiple opinions that comprised its Opinion and Final Order as well as from the various briefs filed on its behalf in this Court and the Court of Appeals—underscores the full range of second guessing that a federal tribunal can and will undertake under the guise of “unobtrusive” review of state action. In this case, such review ranged from seemingly nonintrusive findings that certain filings (typically minor endorsement filings) simply were not reviewed, to findings that the state regulator made the “wrong” decision based on the evidence presented to him.

On one end of the spectrum, for example, the record shows that state regulators allowed the initial rate bureau filings in two states to go into effect without requiring detailed supporting data. See Pet. App. at 60a-61a, 63a. The evidence further shows that the regulators concluded that this was appropriate, because the new rate bureaus had not had any opportunity to develop historical data with respect to a new filing, and because the initial rating bureau rates tracked the preexisting competitive rate in the respective markets. *Id.*; see also Joint App. at 3. The FTC felt differently, however, concluding that no active supervision occurs “[w]hen a state allows a historical rate to go into effect unexamined.” Pet. App. at 68a.

On the other end of the spectrum, the FTC's “unobtrusive” test of active supervision ignored unambiguous evidence of rigorous scrutiny by Arizona and Connecticut regulators of comprehensive rate filings in those states. Instead, relying on his experience as a former Interstate Commerce Commissioner, the author of the FTC opinion concluded that the personnel who reviewed the Arizona filing were not “sufficiently trained” to carry out this “very difficult task.” Pet. App. at 135a and n.17. As to the Connecticut filing, this same Commissioner concluded, despite testimony by the regulator that he had thoroughly

reviewed all aspects of the filing in question, that the regulator “should have disapproved the rates as excessive.” Pet. App. at 132a. Both of these filings were found by the FTC, under its supposedly deferential test of active supervision, not to have been actively supervised.

Neither of these extremes can be reconciled with the notion underlying the *Parker* doctrine that state regulators are to be given latitude to adopt flexible regulatory alternatives. Even a putatively nonintrusive form of federal substantive review, such as the “basic level of activity” test adopted by the Court of Appeals, violates the state action predicate because the regulator may well have concluded that his limited regulatory resources were better targeted elsewhere with respect to the filing in question.¹⁰ In other words, even *apparent* inaction by a regulator with respect to a filing (*e.g.* the absence of paper in his or her files), may reflect a regulatory judgment on his part that the particular filing in question did not require utilization of limited regulatory resources.¹¹ A finding of no active supervision with respect to such a filing is nothing short of a federal substantive determination that the state official erred in exercising his regulatory judgment.

As the examples listed above demonstrate, any test of active supervision—including the Third Circuit's “basic level of activity” test—that invites federal scrutiny into the nature, rather than the existence, of state regulatory pro-

¹⁰ Indeed, the record demonstrates that this is precisely what occurred in this case. See *e.g.*, Joint App. at 81 (regulator testified that his responsibilities include the determination of which rate filings require greater or lesser scrutiny).

¹¹ The fact that state troopers may not succeed in stopping every speeder, for example, does not mean that state speed limits are not being enforced. By the same token, a regulatory judgment that rate bureau filings will be reviewed randomly in an effort to preserve state regulatory resources may not strike a federal reviewing authority as the best form of supervision; nevertheless, such a determination would appear to represent the precise type of regulatory flexibility that the *Southern Motor Carriers* decision explained was so crucial in a state action context.

grams, places federal reviewers on the fabled slippery slope. The state action doctrine will cease to function as a rule governing regulated conduct, and will operate as an *ad hoc* tool subject, as this case demonstrates, to varied and inconsistent applications by federal tribunals. As such, it will offer no clear guidance to regulated entities, and will undermine the ability of states to carry out their regulatory regimes free from federal intrusion.

III. An Objective Test Of Active Supervision Avoids Abuse Of State Regulatory Processes.

Both the FTC's test of active supervision and that of the Third Circuit would allow federal antitrust challenges to be based upon alleged misfeasance or nonfeasance of state regulators. Such tests impermissibly replace the state reviewing authority contemplated by the legislature with a federal reviewing authority operating pursuant to a different mandate. As this Court explained in *Hoover v. Ronwin*, 466 U.S. 558 (1984), "[t]he court did not suggest in *Parker*, nor has it suggested since, that a state action is exempt from antitrust liability only if the sovereign acted wisely after full disclosure from its subordinate officers." *Id.* at 574. For precisely these reasons, the First Circuit, in *New England Motor Rate Bureau*, rejected the FTC's attempt to inquire "into whether a particular state's regulatory operation demonstrates satisfactory zeal and aggressiveness," 908 F.2d at 1075, concluding that "[t]he FTC would, in effect, try the state regulator." *Id.*¹² The Third Circuit below properly adopted the First Circuit's reasoning, and rejected precisely the same intrusive FTC approach to active supervision.

"'Ordinary errors or abuses in the administration of powers conferred by the state should be left for state tribunals to control.' . . . A contrary rule would tempt aggrieved parties to forego available state corrective processes in hopes of obtaining the treble damages remedy

¹² The court held that the FTC's effort to sit "in judgment upon the degree of strictness or effectiveness with which a state carries out its own statutes" *id.* at 1076, "goes too far." *Id.* at 1075.

conferred by the Sherman Act." *Boone v. Redevelopment Agency of San Jose*, 841 F.2d 886 (9th Cir.), *cert. denied*, 488 U.S. 965 (1988). This is not merely a hypothetical possibility, but a demonstrated reality. One plaintiff's counsel, when asked by a district court why he did not exhaust his state law remedies for challenging a state administrative decision, candidly admitted that "we believe the antitrust laws apply and that's our remedy." *Metro Mobile CTS, Inc. v. Newvector Communications, Inc.*, 661 F. Supp. 1504, 1520 n.12 (D. Ariz. 1987), *aff'd*, 892 F.2d 62 (9th Cir. 1989).¹³

¹³ This quoted excerpt from the district court opinion fails to do plaintiff's counsel full justice. The transcript of the argument demonstrates without ambiguity plaintiff's efforts to foreclose active supervision by moving to federal court before state regulatory procedures had been exhausted. After concluding that plaintiff's complaint focused on a regulatory determination that plaintiff thought to be in error, the following colloquy occurred:

Court: Why didn't you appeal at that time?

Counsel: Because we believe the antitrust laws apply and that's our remedy, Your Honor.

Court: But you'd also said the Corporation Commission indicated that it had rate setting authority and jurisdiction and you could have simply appealed that to superior court, and we wouldn't be here today. . . . You still haven't said why you didn't appeal that [regulatory action].

Counsel: Because, Your Honor, we—we—we believe we did not want retail rate regulation, and we knew we had remedies elsewhere. . . .

Court: So that your answer is that you just felt that you didn't have to appeal it, that you had an action here for treble damages?

Any test of active supervision that invites federal review of the actual conduct of state regulators promotes precisely such forum shopping by placing in the hands of potential plaintiffs the power to control the presence or absence of state supervision. In other words, by failing to avail himself of the full range of regulatory remedies provided by a state, an antitrust plaintiff can manufacture the absence of active supervision under a state action test that scrutinizes the substance of state regulatory conduct.¹⁴ Such a regime would enable "aggrieved parties to forego available state corrective processes in hopes of obtaining the treble damages remedy conferred by the Sherman Act." *Llewellyn v. Crothers*, 765 F.2d 769, 774 (9th Cir. 1985).

In addition, a test that invites federal review of whether a state regulator "properly" performed his or her statutory duties—or was qualified to perform them¹⁵—inevitably

Counsel: Your Honor, at this point . . . we don't want rate of return rate regulation. We don't want rate of return wholesale rate regulation. We're in favor of competition. That's why we didn't—we don't want the [regulator] to assert rate regulation over retailing. That's why we didn't appeal.

Id. (Transcript at 47-51).

¹⁴ As one noted antitrust scholar has explained:

State laws intended to displace the antitrust laws may delegate to public agencies or officials the power to act, decide, or regulate in order to achieve anticompetitive results. Of course, state law "authorizes" only agency decisions that are substantively and procedurally correct. Errors of fact, law or judgment by the agency are not "authorized," and state tribunals will normally reverse erroneous acts or decisions. If the antitrust court demands unqualified "authority" in this sense, it will inevitably become the standard reviewer of governmental agencies whenever it is alleged that the agency, though possessing the power to engage in the challenged conduct, has exercised its power erroneously.

P. Areeda, *Antitrust Immunity for "State Action" after Lafayette*, 95 HARV. L. REV. 435, 449-50 (1981).

¹⁵ See Pet. App. at 135a and nn. 15-18.

will open the doors to invasive federal discovery of the state regulatory process. Already protracted discovery will be further expanded (as occurred in this case) as testimony of regulators and their staffs is demanded and regulatory files are scoured by private or public federal litigants. This Court has cautioned against this very situation in *City of Columbia v. Omni Outdoor Advertising, Inc.*, 111 S. Ct. 1344 (1991), where it rejected the plaintiff's efforts to craft a conspiracy exception to the state action doctrine, in part because "[t]his would require the sort of deconstruction of the governmental process and probing of official 'intent' that we have consistently sought to avoid." 111 S. Ct. at 1352.

As Justice Kennedy explained while sitting as a judge on the Ninth Circuit:

[A]ntitrust immunity springs from an essential principle of federalism, the necessity to respect a sovereign capacity in the several states. Given this purpose, it follows that actions otherwise immune should not forfeit that protection merely because the state's attempted exercise of its power is imperfect in execution under its own law.

* * * *

The availability of immunity . . . does not depend on the subjective motivations of the individual actors, but rather on the satisfaction of the objective standards set forth in *Parker* and authorities which interpret it.

765 F.2d at 774; see also *In re Real Estate Title and Settlement Services Antitrust Litigation*, MDL No. 633, mem. op. and order (E.D. Pa. June 10, 1986) ("the 'active supervision' element of the state action defense focuses on the required procedures by which the state controls the challenged setting of prices, not the behavior or effectiveness of individual state employees in carrying out those procedures"). Consistent with these admonitions, an objective test of active supervision focuses upon state pro-

cedures, and thus avoids the problems inherent in the tests employed by the FTC and the Court of Appeals. Under such an objective test, "[a] federal Court's role in assessing active supervision is limited to whether provisions for regulatory oversight exist, and, if necessary, whether the specific conduct alleged to be anticompetitive is included as a part of the regulatory oversight." *Metro Mobile*, 661 F. Supp. at 1520.

Under this structural approach, a plaintiff aggrieved by the conduct of state regulatory activity must exhaust available state remedies; a plaintiff may assert that active supervision is lacking only if no mechanism is provided by state law for the review and correction of state regulatory inadequacies, *Patrick*, 486 U.S. at 104-05, because only then can it properly be argued that the state has shrouded private anticompetitive conduct in a "gauzy cloak" of state involvement. *Midcal*, 445 U.S. at 106. Abuses, mistakes or other irregularities in the statutorily established state regulatory structure cannot, consistent with *Parker* and its progeny, become the subject of federal antitrust review.

IV. An Objective Approach To Active Supervision Avoids Fundamental Fairness Concerns That Easily Could Rise To Constitutional Dimensions.

Although the constitutional ramifications of the FTC's approach to the state action doctrine have not been addressed by the parties, this Court should consider these issues in the course of formulating its holding with respect to the proper parameters of the active supervision standard. The manifest unfairness of the FTC's approach throughout this case is evidenced by the fact that the respondent title companies engaged in precisely the same conduct pursuant to virtually identical regulatory regimes in each of the states at issue before the FTC, but their federal antitrust liability varied from state to state.

More telling still is the fact that the various Federal Trade Commissioners could not even agree among themselves, let alone with their ALJ, as to which states actively supervised the challenged conduct under the Commission's

"test" of active supervision. The FTC's own confusion regarding the proper application of its test underscores the fact that any test of active supervision that centers on the actual conduct of state regulators provides no meaningful notice to regulated entities concerning when their actions will violate the federal antitrust laws, holds these entities accountable for the regulatory imperfections of independent third parties, and imposes liability retroactively and without adequate warning. An objective test that looks solely to the state's mechanisms for regulatory review eliminates all of these concerns.

A. An Objective Test Of Active Supervision Provides Adequate Notice Of Whether Regulated Private Conduct Will Violate Federal Antitrust Laws.

Any test of active supervision that renders a private actor's antitrust liability dependent upon the subsequent conduct of uncontrolled and uncontrollable third parties is not sufficiently definite to withstand constitutional scrutiny. It is a fundamental tenet of due process that "any legal standard must, in theory, be capable of being known." O.W. Holmes, *THE COMMON LAW* 89 (M.D. Howe ed. 1963). Because a "man is free to steer between lawful and unlawful conduct," *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972), this Court has consistently insisted "that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly." *Id.* When a standard is based upon the subsequent conduct of uncontrollable third parties, however, the standard is incapable of ascertainment, and a person of ordinary intelligence cannot control his conduct to insure that it remains lawful; a standard so based thus undermines a core principle of due process that persons must have notice of the conduct for which they may be punished.

In the criminal context, this Court has consistently required that a penal statute "fairly and clearly define the conduct made criminal and the punishment which can be administered." *Berra v. United States*, 351 U.S. 131, 139

(1956). This Court has not hesitated to invalidate a statute where the statute does not fix "an ascertainable standard of guilt, . . . adequate to inform persons accused of violation thereof of the nature and cause of the accusation against them." *United States v. Cohen Grocery Co.*, 255 U.S. 81, 89 (1921); see also, *Connally v. General Constr. Co.*, 269 U.S. 385, 391 (1926); *A.B. Small Co. v. American Sugar Ref. Co.*, 267 U.S. 233, 239 (1925).

The due process principles enunciated in *Cohen Grocery* and *Berra* are equally applicable in the civil context. *Giaccio v. Pennsylvania*, 382 U.S. 399 (1966); *A.B. Small*, 267 U.S. at 238-40. In *Giaccio*, this Court invalidated a Pennsylvania statute that allowed juries to impose court costs on an acquitted defendant. The Pennsylvania Supreme Court had held that the statute did not violate the due process clause because it was not a "penal statute," but simply provided a mechanism for the collection of costs of a "civil character." This Court rejected that approach and concluded that the protections of due process are "not to be avoided by the simple label a State chooses to fasten upon its conduct or its statute. So here this state Act whether labeled 'penal' or not must meet the challenge that it is unconstitutionally vague." 382 U.S. at 402.

Similarly, in *A.B. Small*, this Court held that the ground on which it had made its judgement in *Cohen Grocery*, i.e. that a statute must be sufficiently definite to inform persons accused thereunder of the nature and cause of the accusation against them, "applie[d], and with like consequences, to civil suits as well." 267 U.S. at 240. This Court concluded that the defendant's attempt to distinguish *Cohen Grocery* on the ground that it involved a criminal prosecution was unpersuasive, *id.* at 239, and held that:

The ground or principle of the decision[] was not such as to be applicable only to criminal prosecutions. It was not the criminal penalty that was held invalid, but the exaction of obedience to a rule or standard which was so vague and indefinite as really to be no rule or standard at all.

Id. Regardless of whether the context is civil or criminal, "[a] prohibition so indefinite as to be unintelligible is not a prohibition by which conduct can be governed. It is not a rule at all; it is merely exhortation and entreaty." *Id.* at 240.

A subjective test of active supervision gives rise to precisely these same vagueness concerns, and should be rejected.¹⁶ Under such a subjective test, the challenged conduct becomes blameworthy, if at all, not when it occurs, but only after it has been judged in relation to the activity of state regulators. Short of simply abstaining from state authorized activities, there is no fairly and clearly defined standard by which a person of "ordinary intelligence" could conduct himself. Abstinence, however, is really no alternative at all because it is fundamentally at odds with the very purpose of the state action doctrine—the promotion of regulatory autonomy—and is little different than the compulsion requirement struck down by the Supreme Court in *Southern Motor Carriers* as being irreconcilable with the federalism basis of the state action doctrine.

B. An Objective Test Of Active Supervision Avoids The Possible Imposition Of Improper *Ex Post Facto* Liability.

As amply demonstrated by the record in this case, the Commission's approach to active supervision invites *ad hoc*

¹⁶ The FTC held that, stripped of the state action defense, respondents' activities "have been shown to constitute pernicious antitrust violations." Pet. App. at 108a. Consequently, it would undoubtedly contend that there is no vagueness issue presented by its test of active supervision, because the parties are on notice that price fixing is illegal. This approach, however, flips the state action doctrine on its head. State economic regulation is not first preempted by the federal antitrust laws and then subject to an immunity under the state action doctrine. Rather, the doctrine is premised on the *exclusion* of state regulation from the application of federal antitrust laws. Consequently, in order for a state action test to avoid the notice problem discussed above, it must provide certainty to entities operating pursuant to lawful state regulation as to when their conduct may nevertheless violate federal antitrust laws.

federal reinterpretation of state regulation, which may then be retroactively applied to the conduct of private actors to impose antitrust liability. This application of the active supervision requirement operates like an *ex post facto* law; it subjects private actors to the very real prospect of criminal or punitive antitrust liability solely on the basis of the action or inaction of the state regulators undertaken *after* the private actors have engaged in the challenged conduct.

The due process requirement of prior notice applies also to retroactive application of a new judicial construction of a statute. "There can be no doubt that a deprivation of the right of fair warning can result not only from vague statutory language but also from an unforeseeable and retroactive judicial expansion of narrow and precise statutory language." *Bowie v. City of Columbia*, 378 U.S. 347, 352 (1964). In *Bowie* the Court observed that:

an unforeseeable judicial enlargement of a criminal statute, applied retroactively, operates precisely like an *ex post facto* law, such as Art. I, § 10, of the Constitution forbids. An *ex post facto* law has been defined by this Court as one "that makes an action done before the passing of the law, and which was *innocent* when done, criminal; and punishes such action," or "that *aggravates* a crime, or makes it greater than it was, when committed." *Calder v. Bull*, 3 Dall. 386, 390. If a state legislature is barred by the *Ex Post Facto* Clause from passing such a law, it must follow that a State Supreme Court is barred by the Due Process Clause from achieving precisely the same result by judicial construction.

Id. at 353-54.¹⁷

¹⁷ See also *United States v. Lang*, 361 F. Supp. 380 (C.D. Cal. 1973) (holding that where legal definition of obscenity was substantially changed by the Supreme Court after defendants had mailed the accused matter prosecuting defendants would be functional equivalent of *ex post facto* application of the law); *Meads v. United States*, 156 F. Supp. 938, 940 (Ct. Cl. 1957) ("Parties should not be deprived of rights, established

Where the antitrust liability of private actors depends upon a federal tribunal's subsequent determination of whether the state regulators have properly performed their duties, the same infirmities that have caused the courts to strike down *ex post facto* laws come into play. A test of active supervision that invites federal tribunals to put state regulators on trial in this manner, and to use the results of those trials to determine the antitrust liability of regulated private parties, places those parties at grave risk that they will be found liable for antitrust violations stemming from a federal reinterpretation of state law. This Court should reject any test of active supervision that creates such a risk.

C. An Objective Test Of Active Supervision Avoids The Imposition Of Vicarious Liability On Private Parties Acting In Accordance With The Provisions Of State Law.

Any test of active supervision that hinges on the actual conduct of state regulators predicates a person's antitrust liability on the actions of third parties over whom that person has no control; it thus also raises due process concerns by impermissibly imposing vicarious liability on an innocent party. Vicarious liability has been described as the "shifting of full responsibility to a blameless party, based on the party's relationship or policy considerations." *Minpeco, S.A. v. Conticommodity Services, Inc.*, 677 F. Supp. 151, 159 n.14 (S.D.N.Y. 1988). In the absence of culpability, courts impose vicarious liability only in extremely limited circumstances.

In the criminal context, the United States Supreme Court considered the due process limitations on vicarious liability in *Scales v. United States*, 367 U.S. 203 (1961):

In our jurisprudence guilt is personal and when the imposition of punishment on a status or on

by prior judicial decision and relied upon when the transaction was entered into, by a change in the interpretation of the law, pronounced after the transaction.").

conduct can only be justified by reference to the relationship of that status or conduct to other concededly criminal activity . . . that relationship must be sufficiently substantial to satisfy the concept of personal guilt in order to withstand attack under the Due Process Clause of the Fifth Amendment.

Id. at 224-25; see also, *Houston v. Estelle*, 569 F.2d 372 (5th Cir. 1978)(prosecutor's remarks to jury attempting to "tar defendant with vicarious responsibility for an expletive uttered in open court by a spectator" denied defendant due process of law).

The courts' reticence in holding a person liable for the conduct of another where no "sufficiently substantial" relationship exists is equally evident in the civil context. In *Amoco Oil Co. v. Environmental Protection Agency*, 543 F.2d 270 (D.C. Cir. 1976), the court struck down an Environmental Protection Agency regulation that imposed civil liability on a gasoline refiner for the negligent sale of leaded gasoline by a gasoline retailer. The Court of Appeals for the D.C. Circuit summarized the views of numerous commentators:

Generally, vicarious liability may be imposed upon a non-negligent person by reason of some closely integrated relationship existing between him and the negligent party. The essence of such relationship is that the person to whom the negligence is imputed has sufficient control over the acts of the negligent party to justify the conclusion that he is responsible for what happened.

Id. at 276 (citations omitted).

Similarly, in *Continental Aircraft Sales v. McDermott Brothers Co.*, 316 F. Supp. 232 (M.D. Pa. 1970), the court, in determining whether the negligence of the employee of the defendant corporation could be imputed to the employee of a third-party defendant corporation, held that "[n]egligence in the conduct of one party will not be imputed to another party if the latter party neither author-

ized such conduct nor participated therein, nor had the right or power to control it." *Id.* at 235.

In the present case, the conduct which ultimately determined the culpability of the rating bureau participants was that of third parties over whom the rating bureaus have no right or power to control, no relationship of agency or employment, nor any other relationship "sufficiently substantial" to allow the courts to shift "full responsibility to a blameless party." The underlying unfairness of the imposition of liability upon the respondent title insurers for the misfeasance or nonfeasance of state regulators is palpable. The vicarious liability inherent in such a test of active supervision, therefore, cannot be reconciled with the commands of due process and should be rejected.

CONCLUSION

The Tenth Amendment of the United States Constitution provides that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. CONST. amend. X. Relying on this constitutional notion of state sovereignty, the Supreme Court, in *Parker*, fashioned the state action doctrine as a means of protecting state economic regulation from encroachment by federal antitrust laws.

An objective test of active supervision fully comports with these purposes of the state action doctrine. Such an approach invites a federal reviewing authority to look only at the mechanisms established by a state for supervising regulated private parties. By limiting federal review in this manner, this structural test prevents federal tribunals from second-guessing the wisdom or quality of state regulatory determinations, and preserves for the states the full range of regulatory autonomy found to be so crucial by the Supreme Court in *Southern Motor Carriers*. This test also precludes efforts by private parties to circumvent state regulatory programs by pursuing spurious federal damage claims against parties subject to the process and protection

of state law. Finally, the objective test of active supervision provides clear and unmistakable guidance to regulated entities concerning what nominally regulated activities will be subject to the protections of state law. As such, it is the only test of active supervision that avoids paralyzing state regulatory flexibility, because it enables regulated entities to make fully informed decisions before participating in permissive state regulatory programs.

The "active supervision" prong should be interpreted to provide assurance both to states and to regulated entities that state regulatory programs may be implemented. "Active supervision" means that states must have a regulatory mechanism of oversight in place. Once state law provides for such a supervisory mechanism, private parties must be entitled to act pursuant to such state policy; otherwise, the federalism notions at the heart of the state action doctrine, and the doctrine itself, become a hollow shell.

Respectfully submitted,

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